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SUBJECT: NEGOTIATIONS STALL ON TAKEOVER OF INA; RUMORS OF
RUSSIAN INTEREST IN TIFON

¶1. (SBU) Summary. Representatives of the Croatian government and Hungarian MOL have so far failed to agree on the terms of a share swap that would give MOL a majority stake in the Croatian national oil company INA. The previous shareholders' agreement expired at the end of October, giving MOL greater freedom to trade its INA shares. The Croatians' main priority for the moment is to renegotiate this agreement, which would also give the Croatian government the right to repurchase INA shares should MOL decide to sell out. The Croatian side is also demanding that INA's gas business be separated in hopes of retaining some control over a strategic industry. Economic conditions in Hungary and in energy markets have put MOL in a difficult position as well, leading to rumors that it may try to sell off its chain of Tifon service stations in Croatia, possibly to Russian Lukoil. These reports have not risen beyond the level of rumor, but may make some logical sense as MOL prepares to pay a $900 million bill for the INA stock purchase which ended October 3. End summary.

¶2. (SBU) Negotiations have stalled between the Croatian government and Hungarian MOL on a share swap that would complete the privatization of the national oil company INA by giving MOL a majority stake. MOL currently holds 47.5 percent of INA shares after a public purchase offer that ended at the beginning of October. The GOC still retains 45 percent and its ownership cannot fall below 25 percent in accordance with legislation governing the sale.

¶3. (SBU) Also at issue are the terms of a new shareholders' agreement. The old agreement, which expired on October 28th, limited MOL's freedom to trade its INA shares and gave the Croatian government the right to repurchase INA shares in the event of a MOL takeover. The Croatian government is focusing for now on renegotiating this shareholder agreement, which would extend the government's rights on share trading for five years, and is putting off any decision on the share swap until this agreement is successfully renegotiated. The government has also asked to separate INA's gas operations in a bid to retain some control over a strategic industry. This has fueled speculation that Prime Minister Sanader is in no rush to complete the sale, using the government's remaining INA shares as a bargaining tool to achieve long-term strategic interests.

¶4. (SBU) Current market conditions are partially to blame for the impasse. MOL's stock has already fallen 60 percent this year. Lower fuel prices and wider economic concerns in Hungary have damaged the investment climate. Regardless of these challenges, the expiration of the shareholder agreement has put MOL in an advantageous position. The senior strategic advisor to the INA CEO told us "MOL holds all the cards." MOL can now trade its INA shares freely, or sell out completely without consultation with the Croatian government.

¶5. (SBU) At the margins of the negotiations, rumors have emerged of possible interest in Tifon by Russian Lukoil. Tifon is a chain of service stations owned by MOL which represents INA's main competitor in the retail gasoline business in Croatia. Our INA contact told us he did not believe the rumors were true, but said it made some logical sense for MOL to be looking for a Tifon buyer, given MOL's financial difficulties and the $900 million about to be transferred for its INA shares.

¶6. (SBU) COMMENT. We have seen no independent evidence that Lukoil is in any kind of talks with MOL about Tifon, and the reports may simply be thinly sourced speculation in the press. However, given MOL's bargain stock price, there is a small but real possibility of interest in MOL by foreign firms. Without a new shareholder agreement in place, Croatia would have no means to stop either Tifon, or MOL's shares in INA, from passing to a third party through a takeover of MOL. END COMMENT.

Bradtke